

AVIATION COMPETITION AND CONCENTRATION AT HIGH-DENSITY AIRPORTS

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST,
BUSINESS RIGHTS, AND COMPETITION

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

MARCH 21, 2001

Serial No. J-107-7

Printed for the use of the Committee on the Judiciary



U.S. GOVERNMENT PRINTING OFFICE

76-916 DTP

WASHINGTON : 2002

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
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WEDNESDAY, MARCH 21, 2001

UNITED STATES SENATE,
SUBCOMMITTEE ON ANTITRUST, BUSINESS RIGHTS AND
COMPETITION,
COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The Subcommittee met, pursuant to notice, at 10:06 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Mike DeWine, Chairman of the Subcommittee, presiding.

Present: Senators DeWine, Kohl, and Schumer.

STATEMENT OF HON. MIKE DEWINE, A U.S. SENATOR FROM THE STATE OF OHIO

Chairman DEWINE. Good morning. Let me begin by thanking my colleague, Ranking Member Kohl, for joining me in holding this hearing today.

Herb, thank you very much. He and I share strong concerns about airline consolidation and the impact it will have on consumers nationwide.

Just last month, we held a hearing in this Subcommittee to examine the competitive impact of the announced mergers involving United Airlines, US Airways, DC Air, American Airlines, and TWA. At that hearing, we heard from the CEOs of each of the airlines involved in the transactions, as well as from those at airlines not involved in the mergers. We also heard testimony from experts in the aviation field.

Having considered this testimony, as well as additional information that we have gathered, I have weighed the potential benefits against the potential competitive problems that are likely to result from the pending transactions. I have concluded that if the mergers are approved, on balance, consumers will be hurt more than helped.

In light of this conclusion, we needed to take action. So along with my colleagues Senator Kohl, Senator Grassley, and Senator Reid of Nevada, we have introduced legislation to increase and maintain competition in the domestic aviation industry. If the traveling public is to have access to affordable, quality air service, real competition is essential.

A big part of protecting competition in the industry involves making sure that a sufficient number of competitors have access to airports that are essential in this network business. Currently, two of these key airports, Reagan National and LaGuardia, are subject

to Government slot controls which limit the number of takeoff and landing slots during a day.

If the United and American deals are permitted, those two airlines will control roughly 65 percent of the slots at Reagan National and New York LaGuardia. These are key public resources that airlines need reasonable access to in order for competition to be maintained. Simply put, competition is not served if we allow two airlines to dominate these vital airports.

More important, consumer interests are not served if any airline is permitted to gain such a position through mergers. That is why my colleagues and I have introduced S. 520. Our bill helps to protect access to Reagan National and LaGuardia by adding a new section to the Clayton Act, a new section that will limit the percentage of slots that carriers already holding a large share of the national aviation market can control at these two airports.

Our legislation would ensure that no single airline gains an anti-competitive advantage at these slot-controlled airports. It would do so by not allowing any large airline that controls 20 percent of the total slots at those airports to control more than 20 percent of the slots over any two-hour period.

If such an airline did have more than 20 percent of such slots, that airline would be required within 60 days to either return the slots to the Department of Transportation or sell the slots in a blind auction. This procedure would preserve competition by giving all airlines equal opportunity to bid for the slots and gain access to these airports.

Again, my overriding concern is the welfare of the traveling public. Travelers are frustrated about poor service, delays, and high airfares. The answer to those and other challenges is not more consolidation. The answer is effective competition. We must protect the consumer.

I fear that the airline industry is moving in the wrong direction, toward a consolidated industry, away from a truly competitive, consumer-friendly environment. That is not good news for the industry, and that certainly is not good for consumers. We need to move back to real competition in our domestic aviation industry, an industry that we all recognize plays a vital and necessary role in our Nation.

Since we introduced our bill, I have met with Jim Goodwin, the CEO of United Airlines, and he has expressed to me his concerns about our legislation. I am aware that there are different points of view regarding the bill and its full impact, and I remain open as to ways this bill can be improved to further promote competition and to protect consumers.

I want to thank our witnesses for being here today and I am anxious to hear their testimony.

Let me now turn to the ranking minority member of the Committee, Senator Kohl.

**STATEMENT OF HON. HERBERT KOHL, A U.S. SENATOR FROM
THE STATE OF WISCONSIN**

Senator KOHL. I thank you, Mr. Chairman, for holding this important hearing focusing on our recently introduced legislation to bring competition to high-density airports.

When the airlines were deregulated more than 20 years ago, no one could have imagined that we might end up with just three airlines dominating the skies. But if we are not careful, in only a few months real airline competition may be a thing of the past in our country.

The measure we will examine today could help preserve competition among airlines. It is an important step during this time of massive consolidation in the airline industry. Our legislation would prevent any large national carrier from gaining a dominant share of takeoff and landing slots at either Washington Reagan National or New York LaGuardia airports.

Under our measure, any airline with at least a 15-percent share of the national market cannot control more than a 20-percent share of the slots at either Washington Reagan National or New York LaGuardia in any two-hour period. If an airline exceeds these limits, then it must either return the excess slots to the FAA or sell them in a blind auction to its competitors.

We need to do this for a single simple reason. If one or two airlines dominate these key airports, then in combination with their hubs they can gain effective control of the national market. Let me give you one fact that shows how important these airports are to America's air transportation system. More than one-quarter of the Nation's entire congestion-related flight delays resulted from LaGuardia Airport alone.

Gaining access to slots at these airports is essential for smaller and start-up airlines if they are to compete with the mega-carriers. And if we want competition to survive in the 21st century, then we are going to need these small competitors. This bill will enable smaller and new carriers to have a fair shot at gaining access to these airports and thus help bring real competition both to consumers who travel to and from New York and Washington and also to the Nation's skies as a whole.

We recognize the importance of maintaining frequent and reliable air service to smaller cities, such as those in upstate New York, New England, Ohio, and elsewhere, from these two crucial airports. Competition at slot-controlled airports need not be achieved at the cost of losing service to the smaller communities now currently served from these airports. We will work carefully with our colleagues who represent these communities to ensure that nothing in this bill diminishes this vital air service.

So we thank our panel of witnesses for testifying here today and we look forward to hearing their views on this proposal.

Thank you, Mr. Chairman.

Chairman DEWINE. Senator Kohl, thank you very much.

Let me introduce our panel very briefly.

Hershel Kamen is the Staff Vice President of International Regulatory Affairs for Continental Airlines. His responsibilities include international bilateral negotiations, the analysis of proposed Federal regulations—good luck—and government affairs analysis. He joined Continental in December 1994.

Kevin Healy joined AirTran Airways in April 1999 and serves as the Vice President of Planning for AirTran Airways. As vice president, he oversees the airline's route strategy, scheduling, pricing,

revenue management, reservations, and sales. He most recently served as Director of Domestic Pricing for US Airways.

Kevin Mitchell is the Chairman of the Business Travel Coalition. Mr. Mitchell formed the BTC in 1996 to reduce the long-term cost structure of business travel through increased airline competition. As Chairman of BTC, Mr. Mitchell has previously testified before Congress regarding airline deregulation.

We will start with Mr. Kamen, but before we do that let me turn to Senator Schumer, who does have an opening statement.

**STATEMENT OF HON. CHARLES E. SCHUMER, A U.S. SENATOR
FROM THE STATE OF NEW YORK**

Senator SCHUMER. Well, thank you. This is my first meeting as a member of the Subcommittee, which I am proud to be on, and I want to thank you, Mr. Chairman, and Senator Kohl, your Ranking Member, for holding this hearing, but in general for the great work that you have done in the antitrust area. You are a great team and I very much appreciate what you have done and the opportunity to serve with you.

I would just like to say a brief few words about these mergers which, as you know, are very important to me and my State.

The proposed merger between United Airlines and US Air raises important questions about the future of airline competition, in general. First, will the merger of the world's largest and Nation's sixth largest carriers consolidate the industry to such a degree as to inhibit free and fair competition? Will such a merger spur consolidations of other carriers like Delta and Continental, and American and Northwest? And what will be the effect on the consumer of those mergers?

As to all these questions, the jury is still out. In the meantime, various officials, associations, and airlines have presented a number of options for legislating and the proposal at the forefront is the one by you, Mr. Chairman, and Herb Kohl of this Subcommittee.

The legislation, as I am sure everyone knows here, proposes to limit the amount of takeoff and landing slots major airlines can own at LaGuardia and National, but the bill's biggest effect will be in New York State. As to the overall goal of the bill, fostering competition at high-density airports in an era of increasing airline mergers, I commend my colleagues. However, I just must mention I have two concerns about the bill's specifics.

On its face, forcing major airlines to divest slots in an auction where new entrants will be able to compete for the acquisition sounds ideal. But by placing the slots on open auction, it guarantees that they will go to the carriers with the deepest pockets. Is that the right idea? How will that affect middle-sized cities, such as the ones I represent upstate.

And even economically speaking, while, of course, an auction would be the right way to go, aren't there external economies that we have by having airlines in those cities, jobs that move to those cities, just the accessibility of those cities, et cetera?

Second, there are no specifics as to which slots a carrier must divest. Would United give up one of their ten trips to Chicago or Delta's 22 flights to Atlanta instead of their service to Syracuse, Dayton, or Burlington? Without provisions to protect existing slots for

service to underserved communities like, in my State, Buffalo, Rochester, Syracuse, Ithaca and Albany, the major carrier required to divest slots is likely to take them from these communities rather than their major cash-cow markets.

As Senator from New York, I represent not only the airport most affected by this legislation and the most sought after for entry, but also the interests of upstate communities who have insufficient service with hardly any competition. It is for these reasons that I ask the Chairman and Ranking Member to work with me on the solution to the problems I have laid out so we can move forward with legislation that will help foster competition in the inevitable environment of airline mega-mergers we are headed into.

Mr. Chairman, I thank you again for your leadership on this issue. I thank Senator Kohl. I know that some of your cities have the same concerns as we do here, a little less so because they are further away from the slotted airports, although maybe at O'Hare it is the same situation. I don't know, but I hope we can work together to deal with these problems.

Chairman DEWINE. Senator, thank you very much. I think your points are very well taken and these are things that we clearly need to be working on, and we will.

Mr. Kamen, thank you. What we will do is we have your prepared testimony which, without objection, will be made a part of the record for all three of you. We would ask you to keep your opening statement to 5 minutes. We have lights here, so when you get to the yellow light that means you are down to 60 seconds. Then that will give us the opportunity to have some questions.

Mr. Kamen, thank you.

**STATEMENT OF HERSEL I. KAMEN, STAFF VICE PRESIDENT,
INTERNATIONAL AND REGULATORY AFFAIRS, CONTINENTAL
AIRLINES, INC., WASHINGTON, D.C.**

Mr. KAMEN. Good morning, Mr. Chairman, members of the Subcommittee. I am Hershel Kamen, Staff Vice President, International and Regulatory Affairs, for Continental. On behalf of my 53,400 colleagues, I thank you for inviting me to appear today. As always, it is a special honor to be able to appear before Chairman Mike DeWine, of Ohio, who represents our Cleveland hub and the thousands of people we employ.

Mr. Chairman, Continental Airlines commends you, Ranking Member Kohl, and Senators Grassley and Reid for introducing S. 520. This is exactly the right kind of legislation that must be enacted by Congress now. S. 520, as introduced, addresses the important issue of concentration of federally-limited resources and the need to protect competition in the aviation industry by limiting the ability of airlines to dominate two of the most important airports in our national aviation system—Washington Reagan and New York LaGuardia.

Just six weeks ago, the Chairman and CEO of Continental, Gordon Bethune, sat before you and warned of the impending threat that United and American were making to competition in the airline industry, and I think it is worth repeating today.

Mr. Bethune said that the proposed mega-mergers were designed to create a duopoly and split the United States aviation market,

creating an unbalanced competitive environment. Mr. Bethune also explained that the airline industry would change for the worse, adversely affecting competition, consumers, communities, and employees, and he urged the Department of Justice to fight the proposed duopoly's plans and take actions to stop the mega-mergers. Six weeks later, we still believe that United and American should not be permitted to divide up the aviation market and split US Airways and its rich pool of assets.

Last month, Mr. Bethune urged the Congress, the Department of Transportation, and the Department of Justice to ensure that appropriate slots, gates, and facilities at slot- and capacity-controlled airports be made available to smaller network competitors by the two mega-carriers. If the mega-mergers are allowed to proceed, United and American will operate almost 80 percent of the slots at the four federally slot-controlled airports.

At Washington Reagan and New York LaGuardia, the duopoly will control over 65 percent of slots. It is clear that such a dramatic gap in slot holdings would have a chilling effect on competition. Divestiture of slots, gates, and associated facilities by merged carriers which exceed a dominance threshold would help prevent their domination in a post-merger environment.

There is currently only one airline, US Airways, that controls over 20 percent of the slots at Washington Reagan and New York LaGuardia. One of US Airways' significant competitive advantages has been its immense slot holdings, giving the airline the opportunity and the ability to compete with airlines more than twice its size. In fact, US Airways, a carrier which has recently, and wrongly, been trying to convince the Congress that it is a failing enterprise, has actually been financially successful over time in part because of the niche it has been able to create with its large slot holdings.

S. 520 would have no immediate effect on the current distribution of slots at Washington Reagan and New York LaGuardia. All current slot-holders would keep their relative positions and the current competitive equilibrium would remain. However, should the Government approved the United/US Airways/American mergers, the provisions of S. 520 would prevent nationally dominant carriers from exploiting their massive slot positions, increasing the concentration of slots, and leveraging their market power using their large cache of slots. Frankly, S. 520 is good aviation policy.

Under the proposed legislation, a carrier that has more than 15 percent of the national air capacity cannot control more than 20 percent of the slots at either Washington Reagan or New York LaGuardia. While there are currently 3 airlines that have more than 15 percent of the national available seat miles—United, American, and Delta—not one of them on its own currently own or operate the dominant share of slots envisioned in this bill. Frankly, because the Big 3 have not been able to dominate slots at slot-controlled airports, a competitive equilibrium among the major airlines has developed. This equilibrium must be maintained.

We also support the provisions that allow United, American, and other similarly situated carriers to choose how to reduce the size of their slot holdings to an acceptable level. The bill provides that carriers could sell the slots through a blind auction. A blind auction

is clearly a fair way to dispose of slots, and we believe it will ensure that carriers as big as Continental, Alaska, or America West, and as small as AirTran, Midway, JetBlue, Frontier, or Spirit could bid in an unbiased manner. If a carrier with more than 20 percent slot holdings chose not to use the blind auction procedure, the excess slots would simply be returned to the FAA for redistribution.

Clearly, S. 520 should become law. Carriers would not be permitted to control the limited resources at Washington Reagan and New York LaGuardia, and consumers would benefit from the resulting competition. Mr. Chairman, the ability of small and medium-size carriers to compete is vital to retaining equilibrium in the airline industry. Since the dawn of deregulation, this competitive equilibrium has provided great benefits for consumers and it must be strengthened, not weakened. S. 520 does not stop the mega-mergers from being reviewed or even approved. S. 520 is a very important step in ensuring that competition is retained.

If I can leave you with one final message, it would be this: As Gordon Bethune has said, the proposed mergers are bad for consumers, bad for communities, and bad for airline employees. We and many others know that in a post-merger environment, the United-American duopoly will crush our ability to compete, and we implore you to act now. We believe S. 520 is good aviation policy. Without prompt enactment of this bill, no one will be able to ensure that consumers are spared the turmoil and loss of competition that will be the inevitable result of the proposed mega-mergers.

Mr. Chairman, I would be happy to answer any questions you or the Subcommittee have.

[The prepared statement of Mr. Kamen follows:]

PREPARED STATEMENT OF HERSEL I. KAMEN, STAFF VICE PRESIDENT, INTERNATIONAL AND REGULATORY AFFAIRS, CONTINENTAL AIRLINES, INC., WASHINGTON, D.C.

Good Morning Mr. Chairman and members of the Subcommittee. I am Hershel Kamen, Staff Vice President, International and Regulatory Affairs for Continental Airlines. On behalf of the 53,400 employees of Continental, I thank you for inviting me to appear today. It is a special honor to be able to appear before a Subcommittee headed by Chairman Mike DeWine of Ohio, who represents our Cleveland hub and the thousands of people we employ in Ohio. Continental is honored to have such strong leadership in the Senate and we thank you for this leadership.

The topic I would like to discuss today is the important issue of concentration of takeoff and landing slots in the hands of the largest airlines and the need to protect competition in the aviation industry by limiting the ability of airlines to dominate slot-controlled airports. I would specifically like to discuss S. 520, introduced by Chairman DeWine, Ranking Member Kohl, and Senators Grassely and Reid. This legislation is a very important step in maintaining effective competition in the aviation industry and ensuring that airports where access is limited by federal mandate will not be dominated by one or two of the largest air carriers.

I. INTRODUCTION

There are currently four federally slot-controlled airports: Washington Reagan, New York LaGuardia, New York Kennedy, and Chicago O'Hare Air-21, enacted last year, ends slot restrictions at Chicago O'Hare in 2002 and both New York airports in 2007. No end to slot restrictions was legislated for Washington Reagan. In the interim, the Department of Transportation was mandated to award slots to new entrant and limited incumbent carriers and those airlines that use small aircraft to serve small communities from the New York airports. Based on the high level of demand for the slots and the inability of the airport to handle such high levels of demand, the FAA capped the number of slots at New York LaGuardia and allocated slots to new entrant carriers and carriers using small aircraft to serve small commu-

ities based on a lottery system. New York JFK has not faced as much demand and no special limitations have been implemented there.

Given Air-21 and the developments that have taken place since its enactment, it can be safely assumed that slot restrictions at New York LaGuardia are likely to be reinstated. Additionally at Washington Reagan, slot restrictions are expected to remain in place in perpetuity. S. 520 therefore correctly identifies Washington Reagan and New York LaGuardia as the airports that require special rules to ensure continued competition and to prevent undue concentration of slots in the hands of any air carrier.

II. S. 520 AND THE CURRENT ENVIRONMENT

In the current environment, there is only one airline, US Airways, that controls over 20% of the slots at either of the two airports in question. The remaining slots are distributed among the other carriers in the industry. While US Airways is a significant slot holder, this has been US Airways' competitive advantage, giving it the opportunity and the ability to compete with airlines more than twice its size. With less than 9% of domestic capacity (as defined by available seat miles), US Airways is classified as a medium sized national carrier. As such, it is not a dominant national player, and its disproportionate share of slots at Washington Reagan and New York LaGuardia has not raised significant competitive concerns. In fact, US Airways has been successful in large part because of the niche it has been able to create with its large slot holdings.

S. 520 would have no immediate effect on the current distribution of slots at the two aforementioned airports, including for US Airways. All current slot holders would keep their relative positions and the current competitive equilibrium would remain in effect. What S. 520 would prevent, however, is a nationally dominant carrier from acquiring the slots held by another carrier and thereby increasing the concentration of slots, which would permit it to use this large cache of slots to effectively exclude competitors and leverage that market power nationwide and globally thereby harming competition and consumers.

Under the proposed legislation, a carrier that has more than 15% of the national air capacity (as defined by available seat miles, a standard measure of industry capacity) cannot control more than 20% of the slots at either Washington Reagan or New York LaGuardia. While there are currently three airlines that have more than 15% of the national available seat miles (United, American, and Delta, "the Big Three"), none currently has the significant level of slots envisioned in the Bill. Because these large national carriers have not been able to dominate the slot controlled airports, arguably the two most important business airports in the United States, a competitive equilibrium among the major airlines has developed. Along with the "Big Three", the industry is made up of four medium sized national carriers (Northwest, Continental, US Airways, and Southwest) and three small national carriers (TWA, America West, and Alaska). There also are a number of successful new entrant/low cost/niche carriers that help maintain the balance in the airline industry, all of which hold slots at various slot controlled airports (i.e. Frontier, Midway, Midwest Express, Jet Blue, Spirit, Air Tran).

III. S. 520 AND THE PROPOSED AVIATION MEGA-MERGERS

I previously stated that S. 520 would have no immediate effect on slot distribution. Given this, I think it is important to explain why we at Continental Support such a preventative measure.

Just two months ago the Chairman and CEO of Continental, Gordon Bethune, sat before the full Judiciary Committee and warned of the impending threat that United and American were about to impose on competition within the airline industry. Mr. Bethune said that the mega mergers being proposed by United and American would create an unbalanced competitive environment in which each of the two resulting mega-carriers would be significantly larger than their closed competitor and three times as large as Continental, and would ultimately drive the remaining major carriers out of business or into each others' arms in defensive mergers. Mr. Bethune stated that "The airline industry will change for the worse, adversely affecting competition, consumers, communities and employees." He called on Congress, the Department of Justice, and the Department of Transportation to work together to ensure that competition can survive. He urged the Department of Justice to fight the proposed plans of United and American to form a cartel to dominate the aviation industry, and say no to the mega-mergers. United and American, the two largest airlines in the world, should not be permitted to split US Airways and its rich pool of assets.

Mr. Bethune is not the only person to call for action. In hearings before the Judiciary Committee and the Senate Committee on Commerce, Science, and Transportation, the GAO, academic scholars, and many other airline executives explained the havoc the mega-mergers would cause the discussed specific actions that must be taken to ensure that even a small chance of competitive survival would remain.

At the Judiciary Committee hearing, Mr. Bethune stated the "Congress, the Department of Transportation, and the Department of Justice must ensure that appropriate slots, gates, and other facilities at slot and capacity controlled airports be made available to smaller network competitors by the two mega-carriers." S. 520 is an excellent first step in this direction and on behalf of Continental we applaud Senators DeWine, Kohl, Grassley, and Reid for this proposed legislation.

If the mega mergers are allowed to proceed, United and American will operate almost 80% of all slots at the four federally slot-controlled airports. At Washington Reagan and New York LaGuardia the two airlines will control over 65% of all slots. By way of comparison, Continental (which would be only one-third the size of the mega-carriers) operates 3% of all slots and less than 5% of slots at Washington Reagan and New York LaGuardia. It is clear that such a stark difference in the ability to offer service to consumers would substantially reduce competition.

Under the proposed legislation, United, American, and other similarly situated carriers would have a choice of how to reduce the size of their slot holdings to a level which would allow the minimum essential level of competition at these slot-constrained airports. Carriers could either sell their slots through a blind auction, a fair way to dispose of slots that ensures that carriers as big and Continental, Alaska, and America West or as small as Air Tran, Spirit, Midway, Frontier, or JetBlue, could bid in an unbiased manner, or, if a carrier chose not to use the blind auction procedure, the slots would simply be returned to the FAA for redistribution. The Bill would thus prevent carriers from both dominating the airline industry and leveraging the dominance by controlling the limited resources at Washington Reagan and New York LaGuardia. Congress must act now, in the face of the impending duopoly, to ensure that consumers are spared the turmoil and lost of competition that the United and American mergers would bring.

Mr. Chairman, the ability of small and medium sized carriers to compete is vital to retaining competitive equilibrium in the airline industry. This competitive equilibrium has provided great benefits for consumers and must be strengthened, not weakened by concentration of takeoff and landing slots at two of our nation's most vital airports. S. 520, is a very important step in ensuring that the competitive equilibrium if not replaced with a duopoly and that competition in key airports that are federally restricted, and which have high levels of demand, is retained.

Two months ago, after my Chairman and CEO testified before you, Chairman DeWine, you stated that his comments are always candid. While Mr. Bethune is admittedly a hard act to follow, I hope that I have been able to express the importance of the proposed legislation Senators DeWine, Kohl, Grassley, and Reid have introduced. Continental urges all members of Congress to take this bill, and the threat it is trying to protect against, seriously. We urge its swift passage and enactment.

Mr. Chairman and members of the Subcommittee I think you for your giving me the opportunity to discuss this important topic and for your attention. I would be pleased to answer any questions that you might have.

Chairman DEWINE. Mr. Kamen, thank you very much.
Mr. Healy?

**STATEMENT OF KEVIN P. HEALY, VICE PRESIDENT OF
PLANNING, AIRTRAN AIRWAYS, INC., ORLANDO, FLORIDA**

Mr. HEALY. Good morning, Mr. Chairman, Senator Kohl, Senator Schumer. I appreciate both the opportunity to testify today and your continued attention to the problems related to the consolidation of the airline industry and the factors restricting the growth of low-cost competition.

At a time when there are fewer airlines than at any point since deregulation, your bill addresses a critically important issue. Access to markets like New York LaGuardia and Washington's Reagan National Airport is necessary for low-fare network carriers like AirTran Airways to provide viable and sustainable competition.

At this point, low-fare carriers operate about 4 percent of the slots at the two airports, and we are blocked from growing at either airport. If the pending mergers proceed as currently structured, the two largest carriers will control two-thirds of the slots at Reagan National and nearly 60 percent of the slots at LaGuardia.

This concentration in key airports presents a two-fold problem. First, markets like Reagan National and LaGuardia are the cornerstone of network operations for both established major carriers and low-fare carriers alike. Since deregulation, carriers have established hub-and-spoke systems that are heavily reliant on access to large cities.

AirTran Airways is unique in that we are a low-fare carrier with a hub-and-spoke system that allows us to successfully serve larger markets like Boston, Chicago, and Philadelphia, but also small to mid-sized markets such as Akron, Canton, Bloomington, and Toledo. Our Atlanta hub gives us the critical mass necessary to compete with larger carriers, particularly Delta, United, and US Airways.

Our hub and the ability to serve small to mid-sized communities is anchored by service to high-density markets like New York. However, the ability to expand this network effect is limited due to facility constraints at most major airports. If you are blocked from entering DCA, growing at LaGuardia, and obtaining critical airport facilities at Philadelphia, Newark, and Boston, it becomes impossible to compete in this area of the country. At the same time, United and American are increasing their control of slots and facilities at each of these airports.

Second, as major carriers developed hubs over the last 20 years, they have increased regional strength and amassed market power, primarily through mergers and acquisitions, that gives them the leverage to influence pricing, travel agency and corporate distribution, and especially airport facilities. This market power allows the major carriers to limit or prevent new entry and low-cost competition, limiting or in many cases reversing the benefits of deregulation.

As I mentioned earlier, there are fewer carriers now than at any point since deregulation. In fact, according to the Transportation Research Board, new-entrant carriers have exited more markets since 1996 than they have entered. This is a disturbing trend which will only become worse with continuing consolidation.

The negative effects of consolidation have been well documented by multiple studies, most recently a study entitled "Predatory Practices in the U.S. Airline Industry" issued by the DOT in January. This study outlines the many challenges faced by low-cost carriers, including predatory pricing, increased flight frequency, capacity and predatory scheduling, frequent traveler programs, and travel agency overrides.

The study notes the benefits of low-fare competition and documents the differences in competitive responses to new entry by major carriers when the new entrant is another major carrier versus a low-fare carrier. The study concludes, "Since many of the continuing gains from airline deregulation come from the presence of low-fare carriers, an industry characterized by vigorous opportunities for entry is essential for continuing consumer gains."

The key to vigorous low-fare competition is the ability to build and expand effective networks; in other words, the critical mass necessary to compete against established and entrenched major carriers. The benefits of this competition are substantial. The consumer harm from a lack of competition is equally dramatic.

The DOT's most recent report in their competition series notes that fares in hubs without low-fare competition are generally 41 percent higher. This hub premium is even more pronounced in short-haul hub markets where the study concludes passengers pay 54 percent more than in similar markets with low-fare competition.

The AirTran Airways business model is designed to compete in short-haul markets and has been effective in maintaining price discipline in the markets we serve. Based on DOT data, the competition that AirTran brings to Atlanta saved consumers more than \$700 million in 1999. The network strength derived from access to Reagan National, New York LaGuardia, and other key markets will enable us to expand our business model, create other focus cities and hubs, and compete in more dominated hub-to-hub markets.

The only counterbalance to major carrier market power and hub dominance is the price discipline provided by effective low-fare competition. Access to high-density airports both in terms of slots and facilities is necessary to create effective low-cost competition.

Senate bill 520 increases the opportunities for low-fare carriers to compete at Washington Reagan National and New York LaGuardia in the face of further consolidation. This is an important step in building or expanding strong low-fare networks and continuing the benefits of deregulation, but it is a precautionary move against future mergers.

Most of the gains that have been made in competition today are the result of legislation such as AIR 21. I respectfully urge the Subcommittee to continue to look for more immediate means to increase competition with or without further mergers, and to encourage the DOT to use its existing authority to enforce fair and reasonable competition, and prevent anticompetitive practices and unreasonable concentration.

Thank you again for the opportunity to address these critical issues.

Chairman DEWINE. Mr. Healy, thank you very much.
Mr. Mitchell?

STATEMENT OF KEVIN P. MITCHELL, CHAIRMAN, BUSINESS TRAVEL COALITION, LAFAYETTE HILL, PENNSYLVANIA

Mr. MITCHELL. Mr. Chairman and Ranking Member Kohl, thank you for the invitation to appear before you this morning.

BTC supports S. 520. BTC believes the legislation effectively addresses immediate and deep concerns regarding proposed airline mergers. Moreover, this bill also recognizes that the problems of inadequate competition levels, eroding passenger service levels, and aviation system gridlock are inextricably linked. The proposed legislation would address all three issues at Reagan National and LaGuardia Airports, and have a positive impact beyond these two airports.

With respect to inadequate competition levels, U.S. DOT studies have demonstrated that new competition at congested airports low-

ers fares, especially for business travelers in short-haul markets. Low-fare, new-entrant carriers need access to these strategically important airports to augment their financial success and to have the opportunity to grow into national carriers. Importantly, were the proposed mergers to be approved by U.S. DOJ, through this legislation Continental Airlines would have an alternative to seeking merger partners, thus preventing further industry consolidation.

There is some concern over the potential through this legislation of mid-size communities losing service, as incumbents might choose to retain slots for high-density, high-yield business markets. However, should the proposed mergers be approved, these cities would be at risk of loss service or degraded service, as well as higher fares, as these new mega-carriers seek to rationalize routes, hubs, and fleets. There are options to prevent these communities from losing service that I hope this Committee will consider.

Regarding eroding passenger service levels, the proposed legislation would provide new competitive choices at these two important airports, and encourage all carriers to compete not just on price, but on customer service as well. It would appear that none of the proposed passenger rights bills would be, in the long run, as effective in improving customer service as additional competition would be.

Now, to aviation system gridlock. Reportedly, many incumbent airlines distort the efficient use of airport capacity by sitting on slots, by assigning them to smaller aircraft or business affiliates to keep them out of the hands of competitors. By eliminating this waste and inefficiency, this legislation will encourage the highest and best use of all essential airport facilities, including slots and gates. The utilization of larger aircraft would have a positive impact on airport capacity and on aviation system gridlock.

So what is the main issue? Members of this Subcommittee, economists agree that some markets do not work well; other markets do not work at all. After 4 years of national debate over competition levels in commercial air transport, the problems are well documented. The proposed airline mergers would gravely injure what functioning competition is left in this market. Your legislation, if enacted, may stave off highly undesirable outcomes.

There are numerous potential short-term negative consequences associated with these mergers. The huge cost of integrating these firms will likely be financed by business travelers in cities like Rochester, Pittsburgh, and other captive markets where the new mega-airlines will be able to extract monopoly rents. Likewise, customer service problems will be serious, if experience from previous mergers teaches us anything.

As serious as the short-term implications are, customers who oppose these combinations are most concerned with their potential long-term negative outcomes. It is assumed by most experienced corporate purchasers that as a consequence of fewer competitors, business air fares will climb well above current record levels.

Thank you for requesting the views of the customers of the air transportation system.

[The prepared statement of Mr. Mitchell follows:]

PREPARED STATEMENT OF KEVIN P. MITCHELL, CHAIRMAN, BUSINESS TRAVEL
COALITION, LAFAYETTE HILL, PENNSYLVANIA

My name is Kevin Mitchell. I am Chairman of the Business Travel Coalition (BTC), which represents the business travel interests of major corporate buyers of commercial air transportation services, as well as the 21,000 independent business travelers who are members of the Commercial Travelers Association.

BTC supports proposed legislation that would prohibit any airline with more than 15% of domestic available seat miles to own or operate more than 20% of the slots at LaGuardia or Reagan National airports in any two-hour period.

BTC believes the bill strongly addresses immediate and deep concerns regarding proposed airline mergers. Moreover, this bill also recognizes that the problems of inadequate competition levels, eroding passenger service levels and aviation system gridlock are inextricably linked. Proposed legislation would address all three issues at Reagan National and LaGuardia airports, but its positive impact would be felt countrywide.

COMPETITION

U.S. DOT studies have demonstrated that new competition at congested airports lowers fares; especially for business travelers in short haul markets. Low-fare, new entrant carriers need access to these strategically important airports to augment their financial success and to have the opportunity to grow into national carriers. Importantly, were proposed mergers to be approved by the U.S. DOJ, Continental Airlines, through this bill, would have an alternative to seeking merger partners, thus preventing further industry consolidation.

Some are concerned over the potential, through this legislation, for mid-size communities to lose service as incumbents might choose to retain slots for high density, high yield business markets. However, should proposed mergers be approved, these cities would be at even higher risk of lost service and higher fares as these new mega carriers seek to rationalize routes, hubs and fleets.

Another concern is low-fare new entrants may be effectively locked out of the auctioning process for slots that the legislation calls for because of their high prices. I am hopeful that this Committee will be receptive to proposals that would address these potential problems. These communities would then be assured of continued service under multiple scenarios, and additionally, they would benefit from affordable airfares.

PASSENGER SERVICE

Proposed legislation would provide new competitive choices at these two important airports and encourage carriers to compete not just on price, but on customer service as well. It would appear that none of the proposed passenger rights bills would be, in the long run, as effective in improving customer service as additional competition would be.

AVIATION SYSTEM GRIDLOCK

Reportedly, major incumbent airlines distort efficient use of airport capacity by "sitting and slots" by assigning them to smaller aircraft or business affiliates to keep them out of the hands of competitors. This legislation would encourage the highest and best use of all essential airport facilities including slots and gates. The utilization of larger aircraft would have a positive impact on airport capacity and on aviation system gridlock.

THE MAIN ISSUE

Members of the Committee, economists agree some markets do not work well; other markets do not work at all. After four years of national debate over competition levels in commercial air transport, problems are well documented. Proposed airline mergers would gravely injure what functioning competition is left in this market. Your legislation, if enacted, may stave off highly undesirable outcomes.

There are numerous potential short-term negative consequences associated with these mergers. The huge costs of integrating these firms will likely be indirectly financed by business travelers in cities like Rochester, Pittsburgh, Charlotte and other captive markets where the new mega airlines will be able to extract monopoly rents. Likewise, customer service problems will be serious if experience from previous mergers taught us anything.

As serious as the short-term implications are, customers who oppose these combinations are most concerned with their potential long-term negative outcomes. It

is assumed by most experienced corporate purchasers, that as a consequence of fewer competitors, business airfares will climb above current record levels.

Of deep concern is that the new airline behemoths will possess massive new resources of all manner—political, financial, airport facilities, network scale and scope, code sharing and strategically targeted frequent flyer, commission override and exclusive corporate discount programs—to attack Southwest and other low-fare airlines on multiple fronts at once. These low-fare carriers have provided what pricing discipline there is in commercial air transport.

Thank you for requesting the views of the customer of the air transportation industry.

Chairman DEWINE. Mr. Mitchell, thank you very much.

Let me first start with a question to all of you, and I want to follow up on a comment that was made by Senator Schumer. Some people have raised the concern that large carriers will choose to drop service to some small or mid-size communities if they are required to divest slots pursuant to our bill. Others have noted that while that may happen in a few markets, competitive carriers will almost certainly enter the markets after the large carriers pull out.

I just wonder what your opinion about all that is. Mr. Kamen?

Mr. KAMEN. Small and medium communities have service today because there is a market for them. That is the reason US Airways operates them today. They are not operating them to lose money. They are operating them because there is a market there.

If slots are transferred and the carriers that have to transfer the slots cease operations in those markets, there will still be a market. There will still be passengers that want to fly between Washington Reagan, New York LaGuardia and those small communities, and so other carriers will start to pick up those cities.

Chairman DEWINE. That is not something that a larger airline uniquely has the ability to be competitive and make money on?

Mr. KAMEN. I don't think so, I don't think so. Additionally, as Mr. Healy said as well, carriers are trying to build connecting complexes at these airports. So you need a broad mix of communities to serve. You need large communities, smaller communities, to make the network work.

If I can give you one example, with our small slot position we have today at New York LaGuardia, we currently serve two of our hub airports, Houston and Cleveland. We serve two large Florida cities, Fort Lauderdale, and Orlando. But we also serve four small communities. We serve Richmond, Buffalo, Madison, and Grand Rapids. We are not trying to take all the slots and move them only to large communities. There needs to be a broad base in order to make the network work.

Chairman DEWINE. Mr. Healy?

Mr. HEALY. Senator, I think there are a couple of issues there. The first thing I would say is that a number of small communities have already lost service as the major carriers are building up markets like DCA-Boston. DCA-Manchester has fewer flights today than it did a year ago.

The other is the ability to serve smaller communities. As I mentioned before, our network and the core strength that we gain in our network has allowed us to go into markets that large carriers have abandoned. Akron-Canton is a good example. Toledo, Bloomington, and Moline are all markets that either no longer had jet service or in some cases hardly had any service at all.

The key, though, is the strength of the network and being able to serve multiple destinations in large markets. As major carriers pull down in cities, that does in some ways give us an opportunity, particularly in small to mid-size communities, to come in and initiate service.

It is often stated that, well, the communities weren't large enough to support the traffic or jet service. What we have proven time and again—when we entered into Akron-Canton to Atlanta, we cut fares by more than 50 percent and traffic grew by about 1,400 percent. So the communities are certainly strong enough. Given the opportunity and the strength that we can garner through access to large markets, we certainly hope to expand service going forward.

Chairman DEWINE. Mr. Mitchell?

Mr. MITCHELL. Yes, Senator, I would make a comment first and then respond to your question. The comment is that I have been trying since being invited to testify before you today to determine what is the number of slots at both LaGuardia and Reagan that are currently being used for service to mid-sized communities. I cannot find the answer to that and it is an important question because it defines what the scope of the potential problem is here.

To answer your question directly, I think it is pretty clear that some carriers, if relegated to the 20 percent, would consider pulling service out of mid-size communities. But they would not do so because those routes are unprofitable. Indeed, they are some of the highest-yield markets in the system.

Why they would be pulling these flights out would principally be because where they do face competition, they would be loathe to put themselves in a position of having fewer frequencies vis-a-vis their competitors. So they will be pulling out not because of profitability.

What will happen? Well, it will open up the opportunity for niche carriers to fill in there, and it is a beneficial strategy for them because they are staying out of the big guy's way, and that has been proven to be helpful. So you are going to get service to be provided by new entrants.

There is a third benefit here, and that has already been brought up in some respect, and that is you will be giving these smaller carriers some feed through their system that will allow them to serve even more markets and grow into national carrier status.

David Needleman of JetBlue made this point before a Senate Committee a couple of weeks ago where he said, we would love to serve some of Senator Hollings' airports, but without access to Boston we can't get the feeder traffic through Kennedy.

Chairman DEWINE. Well, my time is up, but let me just follow up with you, Mr. Mitchell. Why can't you get this information that you are looking for?

Mr. MITCHELL. It could be a function of I didn't have enough time.

Chairman DEWINE. That works with all of us, I guess.

Mr. MITCHELL. But I have made several calls over to DOT and the data are not easily available, apparently.

Chairman DEWINE. Really? I am surprised by that.

Senator Kohl?

Senator KOHL. Thank you, Senator DeWine.

Mr. Kamen, if all the pending airline mergers and acquisitions are completed as planned, then the two large remaining airlines, American and United, and their affiliated and partner carriers will control about two-thirds of the takeoff and landing slots at Reagan and at New York LaGuardia. These two airlines will also control about half of the national market after these mergers.

In your opinion, what will be the consequences for competitors like Continental if American and United gain such domination at these two slot-controlled airports?

Mr. KAMEN. I think United and American will use their position, their two-thirds and possibly growing position at Reagan and LaGuardia to further intensify their domination of the national aviation system.

Other carriers like Continental—we have testified and stated for the record that we do not believe we will be able to compete with carriers that are three or possibly more times as large as we are without being able to access vital markets like LaGuardia and Washington Reagan, and we will just lose further and further ground on the national scale as we lose ground in these two vital airports. Competition will be lost.

I think that the Chairman of Continental, Mr. Bethune, was very clearly when he testified before the full Committee six weeks ago that we will have no choice but to look for other options, consolidation options, if the mega-mergers are allowed to proceed. We just will not be big enough. We will not be able to grow big enough without help in order to do that.

S. 520 gives us a fighting chance. It allows us the opportunity to bid on slots. We may win them, we may not win them, but if we do, it gives us a fighting chance to go on by ourselves and not have to consolidate. But without it, we just will not have any choice.

I should note that S. 520 would affect Continental if it went ahead and was forced to consolidate with another airline. There has been wide speculation that Continental would be talking to Delta Airlines about possibly consolidating those two carriers. S. 520 would affect us if we merged with a Delta Airlines the same way that it is affecting United and American. It is just good aviation policy. It is trying to help people not be forced to consolidate; it is trying to give competition.

Senator KOHL. Mr. Healy, why is it important to your airline and to other small airlines to gain access to the slots at LaGuardia and Reagan? How does the inability of your airline to obtain takeoff and landing slots at these airports affect your ability to compete with American and United and the other large airlines?

Mr. HEALY. The main issue, Senator, is the network strength that you gain by serving the primary airport. Flying into LaGuardia—you know, the revenue garnered off that percentage is greater than the actual percentage of the seats. It gives you the ability to go in and compete in the market that the people want to go to. That then gives us the ability to serve smaller markets. The differential for consumers is significant. Our fare from Atlanta to Dulles is \$217 at the last minute. The corresponding fare on

Delta Airlines into National is \$609. That is the sort of difference that we hope to make.

We fought very hard to get into LaGuardia. It took about two tries. We had attempted to lease slots and were out-bid and finally got exemption slots into LaGuardia, and that has given us the core strength to continue to grow. Even looking at Newark as an alternative, it took us longer to get into Newark than it did to get into LaGuardia.

So in many cases there isn't an alternative, and without the ability to fly in a network to markets that people want to go to, you don't have the competitive strength to withstand the forces of the major carriers.

Senator KOHL. Well, what about some of these nearby airports like Baltimore, Dulles, and Newark? Could you provide effective competition to the large carriers by flying out of some of these nearby airports?

Mr. HEALY. Well, again, even with Baltimore, if you look at the Southwest effect and say is that effective competition—Baltimore to Hartford, Southwest charges about \$70 on a walk-up basis. From DCA to Hartford, the price is \$290. That I don't think is vigorous competition that is good for consumers.

In New York City, there really are no alternatives within a 50-mile radius. We can't get a gate at Newark Airport either. We are forced to lease services from United Airlines. From our perspective, that puts artificial constraints on the time that we can schedule flights in and out of Newark Airport, and it also substantially increases our costs of operation because we are forced to use their employees at their cost structure, plus a profit margin. We fly there at a lower margin than we could otherwise, but do that because it strengthens the overall network that we operate.

Senator KOHL. Thank you.

Mr. Mitchell, you represent business travel consumers. Do you support efforts to prevent the large airlines from gaining dominant ownership of slots at the slot-controlled airports, and if so why do you believe it is important to consumers that there be limits on the amount of slots that large airlines are able to control?

Mr. MITCHELL. Senator, I think there are three reasons. The first is if ever there is an airport to be a poster child for requiring price discipline, it would be LaGuardia or DCA. So the first thing is we need more competition. We have just come off a year of six price increases for business travelers.

The second thing is having access to these strategically important business centers, these airports, will in many cases be the difference between profit and loss for a start-up carrier. And if ever we needed more new entrants, it is today and it is at a moment in the history of the industry where it is consolidating. So we need to do everything we can to ensure a steady stream of entrants.

Thirdly, these carriers today—it would be analogous to the Federal Government saying to Ford Motor Company, you can sell cars in every city in the country except for Washington and New York. So it is not very equitable from that point of view as well.

Senator KOHL. Thank you, Mr. Chairman.

Chairman DEWINE. Thank you, Senator.

Mr. Mitchell, S. 520 requires excess slots to be sold in a blind auction so that all carriers will have an opportunity to obtain them. But will these provisions allow the low-fare carriers the opportunity really to enter these airports?

Mr. MITCHELL. I think, in theory, these slots are very valuable assets and that there would be opportunity for low-fare carriers to seek financing for them. I also think that as this bill were to play out in the marketplace that you would see some pretty innovative financing take place, perhaps low-fare carriers getting together with other vested interests in communities or airports.

But I think it needs to be understood that, for example, if a Frontier were to come in and have to pay \$500,000 for slots, its prices will have to go up, its fares will have to go up. Surely, there still will be a difference between it and the major carriers, but the effect is that there is a whole stratum of business travelers from smaller companies or independent business travelers that will be wiped out of the market. They will no longer be able to afford a \$500 air fare to LaGuardia.

Chairman DEWINE. Mr. Healy, pursuant to this bill, if a large airline has a code-sharing agreement with a smaller airline at either LaGuardia or at Reagan National, then the slots of that smaller airline will count toward the 20-percent slot limit that the large airline may own or operate. That is the way the bill is written.

Do you believe it is important to include those slots in the calculation?

Mr. HEALY. Yes, I do. Having a code-share relationship particularly with some of the smaller commuter airlines—they essentially are an extension of the major airline franchise, particularly if you look at United's new relationship with Atlantic Coast Airways that flies predominantly as United Express.

In the past, ACA had some autonomy over their fares and their schedules. Under their new structure, United Airlines guarantees them a profit margin for flying and has complete control of the schedule and pricing. So except for a strict ownership, that essentially is a United Airlines flight and they have absolute control over it, so it should be counted as part of their allocation.

Chairman DEWINE. Senator Kohl?

Senator KOHL. I think this is a very important piece of legislation, Mr. Chairman. I clearly understand that our witnesses agree with it, and I appreciate the fact that you are willing to come here today and take your time and express your opinions about this. We will do everything we can.

Chairman DEWINE. Let me just give our witnesses one last opportunity to make any other general comments about how we might improve the bill. Does anyone have a comment besides what you have already said?

Mr. Mitchell?

Mr. MITCHELL. I think there are a couple of ideas that could be considered to address this mid-size community situation. One is to have a set-aside or slots that would be competed for, auctioned off to new entrants if the new entrants were to commit to serving these mid-sized communities.

The other idea and the one I like even more is to get to that number of how many mid-sized communities are being served

today and use that as a baseline, and have a triggering mechanism in the legislation such that if the number of communities falls below that original benchmark, then you might kick in a set-aside provision to ensure that these communities continue to be serviced.

Chairman DEWINE. Well, let me thank our witnesses. I appreciate your testimony very much. It has been important and helpful. If you have additional comments, we would certainly welcome them in the weeks ahead.

We intend to continue to work with the aviation industry and with those interested in this legislation in the coming weeks as we move toward a mark-up in the full Judiciary Committee.

Thank you all very much.

[Whereupon, at 10:55 a.m., the Subcommittee was adjourned.]

